

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

ILLINOIS INDEPENDENT TELEPHONE
ASSOCIATION)

Petition for initiation of an investigation of
the necessity of and the establishment of a
Universal Service Support Fund in accordance
with §13-301(d) of the Public Utilities Act)

Docket No. 00-0233

Illinois Commerce Commission On Its Own)

Investigation into the necessity of and, if
appropriate, the establishment of a Universal
Support Fund pursuant to Section 13-301(d)
of the Public Utilities Act.)

Docket No. 00-0335

REBUTTAL TESTIMONY

OF

LEE H. WHITCHER

ON BEHALF OF

HARRISONVILLE TELEPHONE COMPANY

OFFICIAL FILE

IL C. C. DOCKET NO. 00-0233/0335

Exhibit No. 50

Witness

Date

Reporter

June 12, 2001

Offer of Proof

1 **Q. Please state your name and business address.**

2 A. My name is Lee H. Whitcher. My business address is 213 S. Main St., Waterloo,
3 Illinois 62298.

4 **Q. By whom are you employed and in what capacity?**

5 A. I am employed by Harrisonville Telephone Company as Senior Cost and Rate
6 Analyst.

7 **Q. Are you the same Lee H. Whitcher who filed testimony in this proceeding for**
8 **Harrisonville Telephone Company on April 20, 2001?**

9 A. Yes I am.

10 **Q. What is the purpose of your rebuttal testimony?**

11 A. The purpose of my testimony is to provide policy recommendations based on an
12 embedded economic cost study for Harrisonville Telephone Company that represents
13 the cost of supported services. I also address the issue of implicit subsidies in access.
14 I will also summarize the Company's "affordable rate" recommendations.

15 **Q. Please summarize your rebuttal testimony.**

16 A. Based on the embedded economic cost study, Harrisonville Telephone Company
17 proves a need for funding, and meets the statutory requirement of showing that its
18 economic costs exceed its affordable rate plus recovery from other Federal Universal
19 Service Funding Programs. Since Harrisonville Telephone Company has met the
20 statutory requirement based on this embedded cost analysis, the company should
21 receive state Universal Service Funding based on either its embedded economic cost
22 study or its company-specific Rate of Return showing. The company's state universal

1 service support should not be phased down to the Staff's proposed HAI level of
2 support. Harrisonville Telephone Company is also providing information in this
3 testimony that compares its state switched access revenues to the embedded economic
4 cost for state switched access. This comparison is provided to meet the statutory
5 requirement for identifying subsidies in state switched access. Finally, based upon
6 the findings, observations and analysis of Mr. Thomas Hoops, the Company's
7 existing rates are the appropriate "affordable rate" for the supported services.

8 **Q. Mr. Whitcher, what do you recommend as the appropriate method for**
9 **determining the economic costs of the supported services for Harrisonville**
10 **Telephone Company in this case?**

11 A. Historical embedded costs are the appropriate method for determining the economic
12 costs of the supported services for Harrisonville Telephone Company in this docket.
13 In an order in FCC Docket 96-45 adopted May 10, 2001, the FCC has rejected the use
14 of forward-looking cost models for determining universal service requirements for
15 rural carriers. Specifically, the FCC said in paragraph 177 of that Order that
16 "Because the Commission has not developed rural inputs and it is not possible to
17 determine forward-looking costs for rural carriers at this time, we find that rural
18 carriers should continue to receive support based upon their embedded costs while the
19 five-year plan adopted in this Order is in place." (emphasis added).¹ The Commission

¹ While the specific cost model analyzed in the Rural Task Force Recommendations, which the FCC was relying upon, was the FCC's Synthesis Model, rather than the HAI model which has been presented in this docket, the FCC's finding that forward looking costs cannot be determined at this time due the lack of appropriate inputs for rural carriers is equally applicable with respect to the HAI model. AT&T witness Clark, in his Direct Testimony in this docket, recognizes that the inputs for the HAI model are substantially similar to the inputs in the FCC's

1 should follow the FCC's lead and use historical embedded costs rather than forward-
2 looking costs as the basis for cost determination and universal service funding.

3 **Q. Has Harrisonville Telephone Company had an embedded cost analysis prepared**
4 **for use in this case to show the embedded costs of the supported services based**
5 **on their year 2000 cost separations study?**

6 A. Yes. Mr. Gordon Kraut of GVNW has prepared such an embedded cost analysis and
7 has presented it with his rebuttal testimony in Harrisonville Telephone Company
8 Exhibit 3.0, Schedules 3.01 and 3.02.

9 **Q. Have you reviewed Harrisonville Telephone Company's embedded cost study?**

10 A. Yes. I have reviewed the results generated by this embedded cost study.

11 **Q. Does Mr. Kraut's embedded cost study contained in Exhibit 3.0, Schedule 3.01**
12 **appear to represent a reasonable statement of the embedded costs of the**
13 **supported services for Harrisonville Telephone Company?**

14 A. Yes. This study appears to be a reasonable representation of Harrisonville Telephone
15 Company's embedded costs of the supported services. Schedule 3.01 was developed
16 using Harrisonville Telephone Company's cost separations study estimate run without
17 the weighted interstate DEM factors. Using the unweighted DEM factors in the cost
18 study run, the study results properly reflect the revenue requirement associated with
19 local switching support as a cost assigned to the local jurisdiction. This is an

Synthesis Model when he states on pages 10 and 11 from his Direct Testimony, "the default expense figures in the HAI 5.0a model are supported by forward-looking evidence, and their validity has generally been affirmed by the collection of expense factors that has been adopted by the FCC for its Synthesis model. The FCC developed these expense factors using its own statistical regression analysis, and these factors yield expense levels that match very closely those generated by the HAI 5.0a default factors."

1 appropriate approach for purposes of generating the true local service costs for the
2 company. The economic cost study also eliminates the costs associated with non-
3 supported ancillary services. With this adjustment for ancillary service investment
4 and related expenses, the embedded cost study reasonably represents the economic
5 cost of the supported local services.

6 **Q. What does this Schedule 3.01 show with respect to the economic costs of**
7 **supported services for Harrisonville Telephone Company?**

8 A. Schedule 3.01, Page 1, shows that Harrisonville Telephone Company has economic
9 costs of providing the supported local services that exceed the revenues received from
10 its affordable local rate and federal universal service support mechanisms. This
11 Schedule proves that Harrisonville Telephone Company satisfies the economic cost
12 test contained in the statute and therefore qualifies for support from the state universal
13 fund.

14 **Q. Turning back to Harrisonville Telephone Company's Schedule 3.01 and focusing**
15 **on the IUSF Eligibility amount, can you determine what Harrisonville Telephone**
16 **Company's IUSF support need for supported services will be based on its Year**
17 **2000 embedded economic cost study?**

18 A. Yes. The results of this embedded economic analysis shows that Harrisonville
19 Telephone Company has a revenue deficiency that would generate an Illinois
20 Universal Service Funding eligibility for supported services in the amount of
21 \$3,574,660.

1 **Q. How does the result from the embedded economic cost study compare to the**
2 **Rate of Return analysis filed by Harrisonville Telephone Company in this**
3 **proceeding on April 20, 2001?**

4 A. The embedded economic cost study shows a greater need as it relates to the supported
5 services. The Rate of Return analysis filed by the company demonstrated a
6 deficiency of \$1,064,529 in order to meet the IITA/Staff's proposed rate of return of
7 11.21%.

8 **Q. What is your recommendation to the Illinois Commerce Commission with**
9 **respect to the "economic cost" element of this proceeding, and the appropriate**
10 **level of universal service support funding for the Harrisonville Telephone**
11 **Company?**

12 A. Since Harrisonville Telephone Company has met the statutory requirement based on
13 this embedded economic cost analysis, the company should receive state Universal
14 Service Funding based either on its embedded economic cost study or the company-
15 specific Rate of Return showing, and, not be phased down to the Staff's or AT&T's
16 proposed HAI level of support. I understand that the company's counsel intends to
17 argue in this case that my recommendation could be accomplished through a finding
18 that the embedded cost analysis shows the "economic cost" of the supported services
19 as contemplated by the statute, or a finding that either the embedded economic cost
20 analysis or the Rate of Return analysis can be used as a reasonable proxy for
21 determining the company's need for universal service funding.

1 **Q. Mr. Whitcher, in your opinion do the embedded economic cost analysis and the**
2 **Rate of Return analysis represent more reasonable representations of the**
3 **company's need for universal service support than the HAI model?**

4 **A. Most certainly.**

5 **Q. Do you have any specific reasons why the HAI analysis should not be used to**
6 **determine the universal service funding for Harrisonville Telephone Company?**

7 **A. Yes. Despite the suggestions to the contrary by Staff witness, Mr. Koch, in his direct**
8 **testimony, the HAI model does not only have an upward bias on costs, but rather it**
9 **will tend to overestimate the costs of some companies and underestimate the costs for**
10 **others. AT&T witness, Mr. Clarke, specifically recognizes this point at lines 23-25**
11 **on page 4 of his direct testimony. This conclusion is also consistent with my**
12 **understanding of the findings of the FCC's Rural Task Force in their**
13 **Recommendations to the Federal-State Joint Board on Universal Service adopted on**
14 **September 22, 2000 in CC Docket No. 96-45. (pp. 17-18).**

15 In addition, the evidence of the various parties in this proceeding that have
16 addressed the HAI issue shows that the results on an individual company basis vary
17 widely based on making a small number of input changes in the default values. In
18 adjusting the input values to more closely reflect actual company circumstances, the
19 results from the model can be extremely different from the results produced with the
20 default values. The ICC Staff's HAI proposal for Harrisonville Telephone Company
21 relies heavily on the default values resident in the model and accepts proposed
22 adjustments by AT&T witness, Mr. Clarke, which he states more accurately reflect

1 the defaults in more current versions of the HAI model. At the same time, the ICC
2 staff rejects the majority of the proposed input and default adjustments to HAI made
3 by Mr. Schoonmaker. Staff witness Mr. Koch provides no other rational in his
4 testimony for rejecting the proposed input and default adjustments to HAI made by
5 Mr. Schoonmaker other than that they tend to increase cost (lines 419-435). He
6 provides no justification, based on any studies or other more specific data, of the
7 propriety of the default inputs when applied to local telephone operations in rural
8 Illinois. This position by staff obviously targets an objective in this proceeding of
9 suppressing the level of funding to the qualified companies, and chooses to ignore
10 rational arguments regarding the cost of serving rural Illinois. AT&T witness, Mr.
11 Clarke, in his direct testimony, relies heavily on the FCC's inputs for its Synthesis
12 Model and how closely those inputs compare to the HAI default inputs. ICC Staff
13 witness Mr. Koch accepts the justifications by Mr. Clarke as reasonable in accepting
14 most of his input adjustments for the Staff revised HAI model runs presented in their
15 rebuttal testimony.

16 The difficulty for this Commission in relying on the HAI results of the ICC
17 staff and AT&T and in considering the use of the HAI model for Harrisonville
18 Telephone Company, when there is a reasonable embedded economic cost analysis in
19 the record, is that the FCC has recently stated that the inputs in the existing forward-
20 looking cost models are not appropriate for modeling the costs of the rural carriers at
21 this time. The FCC went so far as to say "it is not possible to determine forward-
22 looking costs for rural carriers at this time." Because the results from forward-looking

1 cost models do not work for small, rural carriers, the FCC has adopted the use of
2 embedded costs for the rural carriers to be used for the purpose of determining
3 universal service support for the next five years. Since the justification by both
4 AT&T and the ICC Staff for their proposed inputs to the HAI model are reliant on the
5 FCC's adoption of the Synthesis Model for non-rural carriers, the recent FCC
6 decision that the model does not yet work for rural carriers essentially renders their
7 HAI model results meaningless and unreliable.

8 **Q. Mr. Whitcher, directing your attention to the Company's Exhibit 3.0, Schedule**
9 **3.01, page 3, was it prepared to show the revenue surplus or deficiency with**
10 **respect to the Company's intrastate access services provided to other carriers**
11 **using the same year 2000 embedded economic cost analysis?**

12 **A.** Yes. Schedule 3.01, Page 3 displays the intrastate switched access revenue
13 requirement and the intrastate switched access revenues for Harrisonville Telephone
14 Company for the year 2000, and it calculates the difference between the net intrastate
15 switched access revenue requirement and the switched access revenues received by
16 the company.

17 **Q. Have you reviewed Schedule 3.01 to determine whether or not there are any**
18 **implicit subsidies in intrastate switched access?**

19 **A.** Yes. As I said, Schedule 3.01, Page 3 displays the intrastate switched access revenue
20 requirement and the intrastate switched access revenues for Harrisonville Telephone
21 Company for the year 2000. The schedule displays the difference between the net
22 intrastate switched access revenue requirement and the switched access revenues

1 received by the company. In the embedded cost study, Harrisonville's intrastate
2 switched access revenues are \$391,993 over its embedded costs, as shown on Line 5
3 of this page of the Schedule. These revenues are the result of usage sensitive
4 intrastate switched access rates that mirror Harrisonville Telephone Company's
5 federal switched access rates. The rates are set in this mirrored fashion based upon
6 the policy decision of the Illinois Commerce Commission in the 4th Interim Order in
7 ICC Docket No. 83-0142.

8 **Q. What do you recommend the Commission do about Harrisonville Telephone**
9 **Company's apparent intrastate switched access revenue surplus?**

10 A. Nothing at this time. It is my understanding that the only requirement in the statute
11 that applies to the small telephone company IUSF fund under subsection (d), as
12 opposed to the fund that would be established under subsection (e), is that the
13 Commission shall identify those surpluses.

14 Contrary to AT&T's position, the statute does not disqualify a LEC from
15 Universal Service Funding simply because its current intrastate access revenues
16 exceed intrastate access costs. Any surplus in access revenues stems from the ICC's
17 mirroring policy. There are policy considerations which the Commission needs to
18 consider before making a decision to break with a policy that has been followed by
19 the companies for 17 years. Also, the FCC is currently reviewing access charges and
20 evaluating various proposals regarding access charge reform. This issue should be
21 left to the next phase of this proceeding. I recommend that the Commission make no
22 changes in access rates in this docket at this time.

1 As an additional point, it should be noted that the rates for intrastate switched
2 access are usage-sensitive, therefore, it would actually be amazing if there weren't a
3 surplus or deficiency each year between the revenue requirement generated by the
4 cost separations study and the actual revenues. The FCC's Rural Task Force, in its
5 Recommendations which I referenced previously, recognized the fact that such a
6 surplus or deficiency is inherent and pointed out that one reason for this inherent trait
7 is the public policy decision by regulators to recover basically fixed costs of operation
8 through usage-sensitive rates. (RTF Recommendations to Federal-State Joint Board
9 on Universal Service, adopted September 22, 2000, released September 29, 2000, p.
10 30). Since the access revenues are based on a per minute rate, the fact that there is a
11 surplus in the revenues, based on year 2000 financial data, does not mean that a
12 higher or lower rate would create a surplus or deficiency in intrastate access revenues
13 in future years. A simple reduction of the rate does not solve the problem, and using
14 this test as a disqualification measure is certainly not the correct answer.

15 **Q. Would it serve the policy of the Universal Service Funding provision to adopt a**
16 **pass-fail test for intrastate access subsidies as proposed by AT&T?**

17 A. Absolutely not. Under AT&T's proposal, as I understand it, a carrier can have
18 \$1.00 of implicit subsidy in intrastate access and lose several hundred thousand
19 dollars in needed support. It would completely defeat the purpose of Universal
20 Service and run contrary to the Commission's policy in Fourth Interim Order of 83-
21 0142 in which carriers were supposed to mirror interstate access rates in the intrastate

1 jurisdiction. No carrier should be denied Universal Service funds for following the
2 Illinois Commerce Commission's mirroring policy.

3 **Q. Please summarize the position of Harrisonville Telephone Company on the issue**
4 **of affordable rate.**

5 A. The position of Harrisonville Telephone Company on the issue of affordable rate is
6 that the Company's current rates are, at the very least, as high as any affordable rate
7 determination that can be made by the Commission. The Direct Testimony of
8 Thomas L. Hoops on Behalf of Harrisonville Telephone Company provides more than
9 sufficient evidence to support this position. Compelling evidence is provided
10 showing that the Company's average residential rate exceeds national average urban
11 residential telephone rates as cited from several FCC studies, as well as average
12 household expenditures on local telephone service from Bureau of Labor statistics.
13 Information is also given to support the premise that the Company's current rates are
14 also at an appropriate level to achieve desirable penetration rates. Evidence is also
15 submitted regarding prevailing economic, demographic and competitive conditions
16 pertaining to the Company's customer base. The testimony submitted clearly shows
17 that the current rates are the affordable rates for Harrisonville Telephone Company.

18 **Q. Does this conclude your testimony?**

19 A. Yes.